Decision **DRAFT DECISION OF ALJ PATRICK (Mailed 8/5/2003)**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the Commission's Own Motion to Consider the Line Extension Rules of Electric and Gas Utilities.	Rulemaking 92-03-050 (Filed March 31, 1992)

OPINION ON PETITION FOR CLARIFICATION OF DECISION (D.) 03-03-032

I. Summary

In response to Pacific Gas and Electric Company's (PG&E) petition for clarification of D.03-03-032 regarding applicant-installed line extension projects, the Commission concludes as follows:

1. The requirement that utilities book the "lower of" the utility's estimated costs or the applicant's actual costs applies only to the refundable portion of the project costs, not to the applicant's total project costs.

2. When booking the applicant's "actual costs," the utilities should use the costs set forth in applicant's third-party contract at the commencement of the project.

3. For purposes of calculating refunds, inspection costs should be fixed at the outset and not be subject to reconciliation on completion of the project.

This proceeding remains open to address the application for rehearing of D.03-03-032 filed by Utility Services Group.

II. Procedural Summary

On April 2, 2003, PG&E filed its petition for clarification of D.03-03-032. On April 22, 2003, the California Building Industry Association (CBIA), and The Utility Reform Network and Utility Consumers Action Network (jointly referred to as TURN) filed responses to PG&E's petition.

III. The Decision

D.03-03-032 ordered the utilities to implement certain changes to their line extension rules for applicant-installed projects. First, the decision requires utilities to change their rules to conform to booking the lower of the utility's estimate or the applicants' costs. Second, the decision converts inspection fees from a non-refundable cost to a refundable cost to the extent that the overall cost of the installation does not exceed the utility's cost estimate for performing the work. Both of these changes impact the rules, approved contract forms, contract administration, field practices, and the accounting treatment for applicant-performed line extension work. The implementation of these changes gives rise to several issues for which PG&E seeks clarification.

IV. Discussion

A. Rule Changes Regarding Accounting for Applicant-Installed Projects

1. Does the Commission's decision requiring the utilities to book the "lower of" the utility's estimated costs or the applicant's actual costs apply to the refundable portion of the project costs or to the total project costs?

Ordering Paragraph 4 of the decision states "[t]he proposal to change the utilities' accounting procedures to require the utilities to book to rate base the lower of the utilities' bid amount or the applicants' costs for applicant-installed projects, is adopted." The decision does not specify, however, whether

the Commission intends this accounting treatment to apply to the refundable portion of the project costs or to the total project costs. PG&E says that under the rationale of the decision, the accounting change should apply only to the refundable portion of project costs, not all of the applicant's costs, but the decision does not make this clear.

TURN says that PG&E correctly points out that there can be dramatically different outcomes in the application of this requirement, depending on whether one is applying it to "refundable" amounts or "non-refundable" amounts. According to TURN, PG&E is right – if the "lesser of estimate or actuals" approach were applied to the non-refundable amounts, it could serve to reduce the ratepayer benefits from implementation of this change, as the non-refundable amounts do not impact rate base.

CBIA disagrees. CBIA says the accounting change should apply to the total project costs, including non-refundable amounts. CBIA argues that while non-refundable project contributions are not included in the calculation of rate base upon which the utility earns a return, "such contributions are included in rate base accounts" which, in turn, are used to develop/determine recoverable utility operating expenses such as O&M and property taxes. CBIA contends that consequently, reductions in these non-capital investment rate base accounts means lower costs for ratepayers.

We reject CBIA's argument. The issue in the decision on which PG&E seeks clarification relates to the TURN/UCAN proposal "to limit the addition to the utility's ratebase on applicant-installed projects." (D.03-03-032, mimeo., p. 15.) CBIA's characterization of non-refundable costs as being "included in rate base accounts" does not change the fact that non-refundable costs have no impact on ratebase and thus are irrelevant to the issue on which

PG&E seeks clarification. According to the decision, the stated purpose of the proposed accounting change is to potentially reduce amounts booked to rate base from applicant-performed work. Further, the decision notes that the only amounts booked to rate base for applicant performed work are allowances plus refunds. (D.03-03-032, mimeo., p. 17.) These amounts are typically referred to as "refundable(s)." In fact, non-refundable project costs do not show up in rate base at all because they are covered by the applicant, either by a cash payment or by an in-kind contribution of the non-refundable items of work. Accordingly, we agree with PG&E and TURN that the accounting change adopted in the decision applies only to the refundable portion of project costs, not to the applicant's total project costs.

2. Are the utilities required to use "actual cost" data from an applicant after the project is complete and all costs are determined, or are the utilities permitted to use an applicant's anticipated costs as set forth in a contract with the installer at the start of a project?

Ordering Paragraph 4 of the decision requires the utilities to book the "applicants' costs" if they are lower than the utilities' bid amount. The discussion section of the decision refers to the applicants' "actual costs," but the decision does not specify whether the figures used can be amounts that the applicants have contracted for with a third-party contractor or whether these figures must reflect the final determination of all costs after project completion.

PG&E notes that the discussion section of the decision cites the TURN/UCAN position that "utilities can receive a simple and accurate accounting of the third-party *billed* cost by requiring the customer to submit an invoice and verified statement prior to receiving any refunds." (D.03-03-032, mimeo., p. 18, emphasis added.) According to PG&E, the citation to this

comment suggests that using the contract price, or "billed" price, for the third-party installation may have been contemplated as opposed to a final accounting of all expenses. Further, PG&E points out that allowing the utilities to use the applicant's costs as set forth in applicant's third-party contract at the commencement of the project will simplify several of the administrative problems created by this accounting change.[1]

CBIA agrees that the utilities should be authorized to use the applicant's third-party contract estimate as a proxy for actual cost.

TURN supports PG&E's proposal to allow the utilities to use the applicant's costs as set forth in the applicant's third-party contract at the commencement of the project.

We note that the decision states: "We are not persuaded that the utilities should need to undertake expensive verification efforts." (D.03-03-032, mimeo., p. 17.) By using applicant's costs as set forth in its third-party contract at the commencement of the project, the utilities would obviate the need to change the terms of the contract after job completion, and obviate the need to withhold refunds and reimbursements pending determination of actual costs. Accordingly, we adopt PG&E's proposal as being consistent with the stated intent of the decision.

[1] In the rare event that the applicant performs the work instead of contracting with a third party, we agree that it should be able to submit a verified estimate of its costs in advance.

B. Rule Changes for Inspection Fees

1. Because the decision converts inspection fees from a non-refundable cost to a refundable cost, should the reconciliation of inspection costs be omitted?

Ordering Paragraph 5 of the decision states that applicants "shall be permitted to apply any otherwise-available line extension allowances to some or all of the cost of utility inspections, to the extent that the overall cost of the installation does not exceed the utility's cost estimate for performing the same work." Currently, inspection fees for applicant-performed work are a non-refundable cost for which the applicant makes a payment up front, with reconciliation of actual inspection fees upon project completion. The decision, however, converts inspection fees to a refundable cost, potentially impacting allowances and refunds.

PG&E says that because refundable costs impact contract terms and payments to applicants, it is important that they not become a "moving target." Since inspection fees under the decision will become a refundable cost, they should logically be fixed at the outset of the project and not be subject to reconciliation, according to PG&E.

CBIA agrees with PG&E that the estimated one-time inspection costs should be used without reconciliation. According to CBIA, the inspection fees should be estimated and collected in advance and be identified in the contract as part of the amount subject to refund.

TURN opposes PG&E's request that for purposes of calculating refunds, inspection costs be set at the outset of the project and not be subject to reconciliation. TURN says it does not understand PG&E's stated concern about avoiding having refundable costs becoming a "moving target." TURN argues

that under current practices, the reconciliation of actual inspection fees upon project completion serves to place the risk squarely with the applicant. According to TURN, reconciliation of inspection cost at the end of the project would keep the risk on the applicants, as it was prior to D.03-03-032.

We reject TURN's argument that reconciliation of inspection costs at the end of a project is required to keep the risk on the applicants. First, we believe TURN's rationale for requiring a reconciliation of inspection costs at the end of a project is not consistent with its position supporting PG&E's request that the utilities be allowed to use applicant's third-party contract costs at the commencement of a project rather than the final costs determined after project completion.

Second, as PG&E pointed out in its petition, if the utilities are required at the completion of the project and receipt of final cost data to revise the figures used for refundable costs, the other contract terms derived from this amount also have to be modified, and payments to and from the applicants are potentially affected. Also, according to PG&E, the problems of waiting until the job is complete are magnified where Rule 16 services are involved, because "build-out" or completion of all services in a development is often a matter of years. Apparently, that is the moving target which PG&E refers to in its petition.

Third, our decision provides: "we will allow inspection fees to become part of the job costs subject to line extension allowances. As long as the total ratepayer exposure cannot exceed the utility's estimated cost for doing the same work, …" (D.03-03-032, mimeo., p. 8.) Thus, there is no basis for TURN's concern that inspection costs must be reconciled at the end of a project to keep the risk on the applicants. Accordingly, we adopt PG&E's proposal that

inspection costs should be fixed at the outset of the project and not be subject to reconciliation for purposes of refunds.

V. Comments on Draft Decision

The draft decision of the ALJ in this matter was mailed to the parties in accordance with Pub. Util. Code § 311(g)(1) and Rule 77.7 of the Rules of Practice and Procedure. Comments were filed on August 25, 2003, by CBIA, PG&E, and Southern California Edison Company (SCE) and San Diego Gas & Electric Company (SDG&E). No reply comments were filed.

CBIA takes exception to the proposed requirement in the Draft Decision that applicants provide the utility with copies of their third-party contract to enable the utility to verify applicants' claims. (Draft Decision, p. 5.) CBIA agrees that PG&E did suggest in its petition for clarification the option of "allowing costs as set forth in a third-party contract at the commencement of the project." (PG&E Petition at pp. 3-4.) CBIA points out that PG&E did not, however, recommend that the contract itself be submitted to PG&E, much less request that D.03-03-032 be revised to require applicant submission of competitively sensitive contracts.

Regarding verification of third-party contract costs, the Commission decision states:

> "…We are not persuaded that the utilities should need to undertake expensive verification efforts. If an applicant were to overstate its costs, the utility estimate would protect ratepayers from charges greater than those that the utility would charge for the same work. If the contractor were to understate its costs, the result would be less exposure for ratepayers in the form of allowances and refunds reflected in ratebase. TURN/UCAN point out that the utilities can receive a simple and accurate accounting of the third-party billed cost by requiring the customer to submit an invoice and verified statement prior to

> receiving any refunds. Because the TURN/UCAN proposal provides an opportunity for costs savings without creating any new ratepayer risk or causing the utilities to undertake any new unrecoverable expenses, it is reasonable to adopt the proposal and we will do so here." (D.03-03-032, pp. 17 and 18.)

As set forth above, the Commission concluded that an invoice and verified statement from applicants will suffice. Accordingly, we will modify the Draft Decision to delete the requirement that applicants provide the utilities with copies of their third-party contracts.

PG&E, SCE and SDG&E generally support the Draft Decision and suggest certain other language changes to eliminate any disputes. We have incorporated these changes as set forth in PG&E's comments.

VI. Assignment of Proceeding

Susan P. Kennedy is the Assigned Commissioner and Bertram D. Patrick is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. The accounting change adopted in the decision requiring the utilities to book the lower of the utility's estimated costs or the actual costs applies only to the refundable portion of any work installed by the applicant.

2. To implement the accounting change adopted in the decision, the utilities should use the applicant's third-party contract anticipated costs at the start of a project as set forth in applicant's third-party contract with applicant's contractor.

3. The decision converts inspection fees from a non-refundable cost to a refundable cost; therefore, inspection costs should be fixed at the outset of the project and not be subject to reconciliation.

4. The decision allows an applicant to apply any otherwise-available line extension allowances to inspection costs, to the extent that the overall cost of the installation does not exceed the utility's cost estimate for performing the same work.

5. To implement the accounting change adopted in D.03-03-032, it is necessary that the applicant provide to the utility on a utility-designed form a verified statement of the refundable amount of its project costs prior to the utility's preparation of the line extension contract between it and the applicant, consistent with the utility's design and construction processes.

6. The utility-designed form should include the following language and choice for applicants: "I choose not to provide to the utility my refundable costs for this project as taken from my contract with my contractor, or as performed by myself, and acknowledge that the utility will use its estimate of the refundable costs for this project in the contract between it and me."

7. The form should also include the following language: "Until the applicant either provides the refundable costs amount of its project from its contract with its contractor, or returns the form indicating that it will not do so, the utility will not proceed with any work on the applicant's project."

Conclusion of Law

The clarification of D.03-03-032, as set forth above, should be adopted.

O R D E R

IT IS ORDERED that:

1. In response to Pacific Gas and Electric Company's petition for clarification of Decision (D.) 03-03-032, for applicant-installed projects, the utilities shall implement the following:

a. The accounting change adopted in D.03-03-032 requiring the utilities to book the lower of the utility's estimated costs or the actual costs applies only to the refundable portion of applicant-installed project costs of any work which is normally the utility's responsibly to install under its line extension rules but which is installed by the applicant.

b. In implementing the above accounting change, the utilities shall use the applicant's third-party contract anticipated cost at the start of a project as set forth in applicant's third-party contract with applicant's contractor.

c. In implementing the decision to allow refund of inspection costs, the utilities shall fix the costs at the outset and the costs shall not be subject to reconciliation for purposes of calculating line extension refunds.

d. In implementing the decision allowing an applicant to apply any otherwise-available line extension allowance to the cost of utility inspections, the overall cost of the installation shall not exceed the utility's cost estimate for performing the same work.

e. Applicants seeking allowances and refunds for applicant-installed projects shall on a utility-designed form provide the utility with a verified statement of the refundable amount of its project costs prior to the utility's preparation of the line extension contract between it and the applicant, consistent with the utility's design and construction processes.

f. The utility-designed form shall include the following language and choice for the applicant: "I choose not to provide to the utility my refundable costs for this project as taken from my contract with my contractor, or as performed by myself, and acknowledge that the utility will use its estimate of the refundable costs for this project in the contract between the utilities and me"

g. The utility-designed form shall also include the following language: "Until the applicant either provides the refundable cost from its contract with its contractor, or returns the form indicating that it will not do so, the utility will not proceed with any work on the applicant's project."

2. This proceeding is closed.

This order is effective today.

Dated _____, at San Francisco, California.